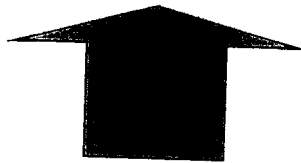


**Because managed care represents lower and/or fixed payment, reducing the cost of operations was a critical success factor.**

## **Rationale**

- Achieving efficiency requires rationalizing services, developing economies of scale, streamlining processes, and sharing best practices
- Alleviating cost pressures requires joint purchasing / standardization programs for supplies and growth to spread overhead costs



## **Market Evidence**

- Philadelphia MSA hospital workforce reduction of 22K – 40K from 1995 to 2000 is primarily related to the need to reduce costs<sup>1</sup>
- JHS
  - ➔ Combined Methodist and St. Agnes management via joint operating agreement
  - ➔ Eliminated duplicative technology investments
- AHERF
  - ➔ Initiated Clinical Outcomes Management Program and Critical Pathways
  - ➔ Consolidated programs, e.g, relocation of transplant and other tertiary services to HUH, relocation of selected services to MCPH
  - ➔ Centralized corporate services and clinical programs oversight

Note (1): 1996 PA Economy League Report on Greater Philadelphia's healthcare economy  
Source: AHERF Strategic Planning and Acquisition materials; BDC Advisors, LLC analysis

The IDS strategy requires health systems to manage between the often conflicting and capital-intensive objectives of service delivery and population management.

### **Managed Care Strategy Rationale**

	<u>Service Delivery</u>	<u>Population Management</u>
• Revenue:	Per unit of service (e.g., fee-for-service)	Per covered life (e.g., capitation)
• Differentiation:	Service / Quality	Cost
• Operational Focus:	Delivery of Services	Population Management
• Efficiency Measure:	Cost Management per Unit	Cost Avoidance
• Operating Units:	Hospital Services and Service Lines	Continuum of Care
• Clinical Focus:	Event / Disease Management	Disease Management
• Risk Assumption:	Intensity	Actuarial
• Triage Competency:	Referral Management	Demand Management

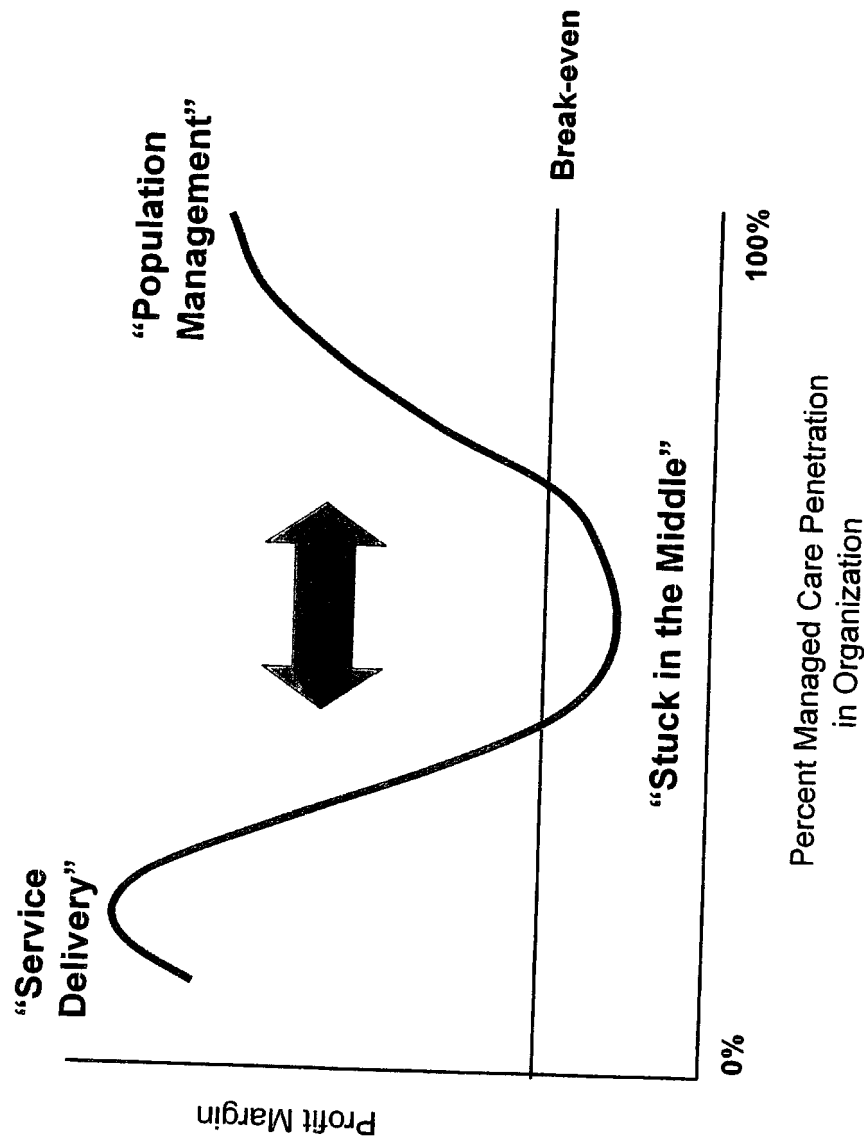
Source: BDC Advisors, LLC

**BDC Advisors, LLC**

## ***IDS Strategy . . . Key Success Factors***

Integrated delivery systems tend to experience better financial performance when they pursue a prevailing strategy between service delivery or population management, rather than pursue both strategies simultaneously.

### **Managed Care Strategy Rationale**



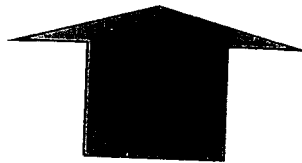
Source: BDC Advisors, LLC

**BDC Advisors, LLC**

The strategic investments made by AHERF-East were capital intensive and did not yield short-term financial returns or immediate hospital cost savings.

## AHERF Delaware Valley Planning Initiative

- Consolidate hospital facilities – Appeal to HMO plans and achieve operating economies of scale
- Acquire physician practices – Generate incremental revenue and control hospital costs
- Enter into full risk contracts – Secure patient volumes and hospital risk pool savings
- Invest in system infrastructure – Implement care management processes to reduce cost, improve quality and increase efficiency of care delivery



## Outcome

- AHERF pursued a physician practice integration and hospital consolidation strategy at a rapid pace in 1996 and 1997 that consumed significant capital
- AHG's capital investment cost and operating losses exceeded its contribution to AHERF-East's financial performance
- Hospital operating scale efficiencies did not materialize to keep up with the slower rate of increase in net patient revenues

Note (1): Developed over a two-year period ending in 1995  
Source: AHERF Strategic Planning and Acquisition materials; AHERF FY 1995-1997 audited financial statements; 2002 Almanac of Hospital Financial & Operating Indicators; BDC Advisors, LLC analysis

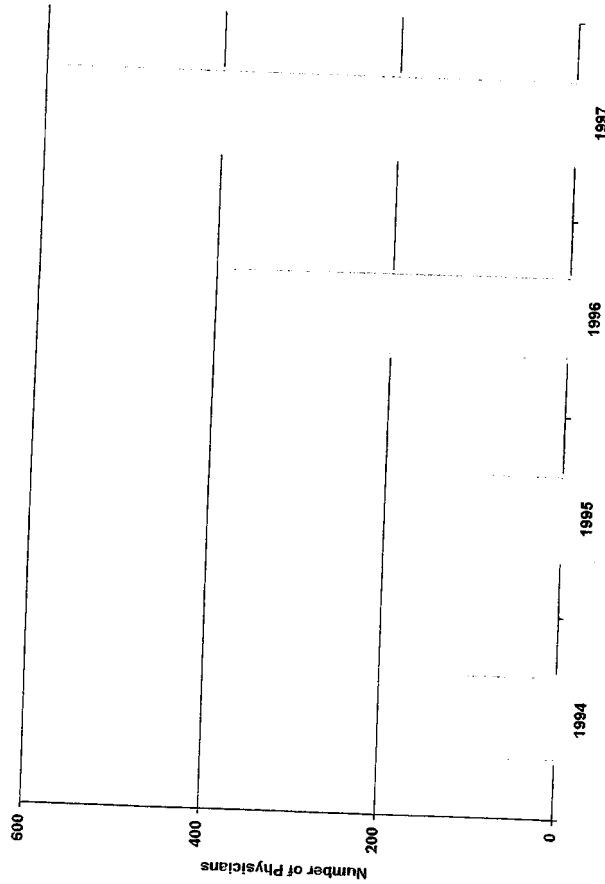
**BDC Advisors, LLC**

## IDS Strategy . . . AHERF Strategic Investments

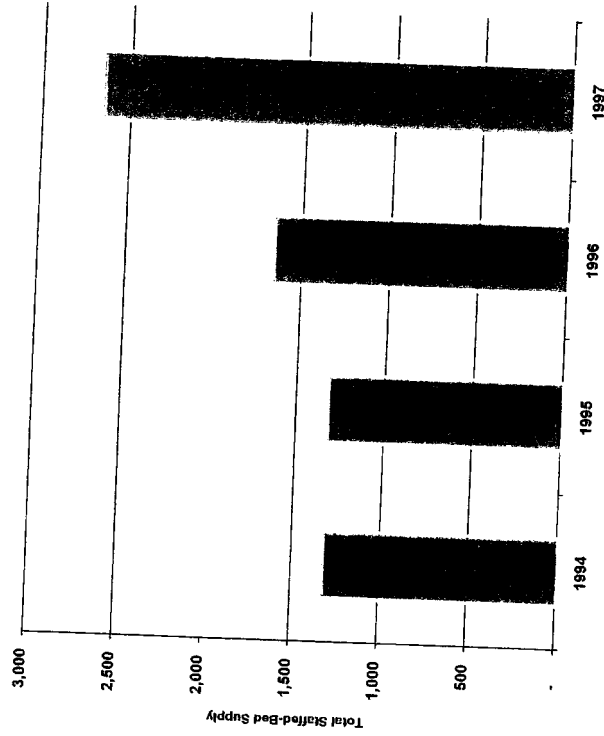
AHERF-East acquired physician practices and consolidated hospital facilities at a rapid pace in 1996 and 1997.

### AHERF-East IDS Growth

AIHG Physician Practice Integration<sup>1</sup>



Hospital Bed Aggregation



Note (1): Approximately 75% of AIHG physician practices were based in the Delaware Valley region, and 25% in the Pittsburgh region.  
Source: AHA Guide to Hospitals, 1994 -1997; AHERF budgets and Board of Trustees annual reports; BDC Advisors, LLC analysis